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REHEARING

7/30/98

BEFORE THE ARIZONA CORPORATION COMMISSION

JIM IRVIN  
Commissioner - Chairman  
RENZ D. JENNINGS  
Commissioner  
CARL J. KUNASEK  
Commissioner

Arizona Corporation Commission

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DOCUMENT CONTROL

IN THE MATTER OF THE COMPETITION IN ) DOCKET NO. RE-00000C-94-0165  
THE PROVISION OF ELECTRIC SERVICES )  
THROUGHOUT THE STATE OF ARIZONA. ) TUCSON ELECTRIC POWER  
 ) COMPANY'S MOTION FOR  
 ) RECONSIDERATION

Tucson Electric Power Company ("TEP" or "Company"), pursuant to A.R.S. § 40-253 and A.A.C. R14-3-111, hereby moves the Arizona Corporation Commission ("Commission") to reconsider its Opinion and Order dated June 22, 1998 in Decision No. 60977 ("Decision").

**BACKGROUND**

On December 26, 1996, the Commission adopted Retail Electric Competition Rules ("Rules") which will change certain retail electric services in Arizona from a regulated monopoly to a competitive marketplace environment. One of the most crucial aspects of these Rules related to the Affected Utilities' ability to recover stranded costs pursuant to A.A.C. R14-2-1607. Section B of this Rule specifically provides that, "The Commission shall allow recovery of unmitigated Stranded Cost by Affected Utilities." Despite this language, as well as the findings of the Stranded Cost Working Group established pursuant to Section C of the Rule, serious disagreement still existed among the various stakeholders as to what this language meant, should it be changed, and if Affected Utilities were to recover stranded costs, how would the calculation and recovery be accomplished. Consequently, pursuant to Commission Decision No. 60351, A.A.C. R14-3-109 and the Commission's Procedural Order dated December 1, 1997, an evidentiary hearing was held. On May 6, 1998, the Hearing Officer filed a Proposed Opinion and Order ("Proposed Order") relating to the

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1 evidentiary hearing. TEP filed its Exceptions to the Proposed Order on May 29, 1998.<sup>1</sup> At a Special  
2 Open Meeting held on June 3, 1998, the Commission amended and adopted the Proposed Order  
3 resulting in the Decision which is the subject of this Motion for Reconsideration.

4 **UNDER THE REGULATORY COMPACT THE AFFECTED UTILITIES ARE LEGALLY**  
5 **ENTITLED TO A REASONABLE OPPORTUNITY TO COLLECT 100 PERCENT OF**  
6 **THEIR UNMITIGATED STRANDED COSTS**

7 The Decision properly lists the Commission's primary objective in resolving the stranded  
8 cost issue as providing the Affected Utilities with a reasonable opportunity to collect 100 percent of  
9 their stranded costs. (See Decision at Page 8.) Thus, methods for stranded cost recovery adopted by  
10 the Commission should afford the Affected Utilities a real opportunity to collect 100 percent of their  
11 stranded costs. In support of this position the Commission states that "based on past  
12 commitments/investments, the Affected Utilities have sunk costs which would be stranded if they  
13 exceed market prices." *Id.* Inherent in the Commission's recognition of the past commitments and  
14 investments is the fact that those undertakings were approved of and authorized by the Commission  
15 itself.

16 The record in Docket No. RE-00000C-94-1065 sufficiently establishes the Affected Utilities  
17 right to a real opportunity to collect 100 percent of their stranded costs based upon the regulatory  
18 compact between the State of Arizona and the Affected Utilities.<sup>2</sup>

19 The testimony of Mr. Bayless and former regulators, Drs. Fessler and Gordon, establish that a  
20 regulatory compact exists and that as a result thereof, the Affected Utilities are entitled to a real  
21 opportunity to recover their stranded costs. See TEP Exhibit 3 at 1-4; TEP Exhibit 9 at 18-19; and  
22 Tr. at 459. Consequently, the Commission properly reached the conclusion to provide the Affected  
23 Utilities with the opportunity to recover 100% of their stranded costs. Unfortunately, based upon the  
24 Decision, the two options that the Commission has permitted the Affected Utilities to employ for  
25 stranded cost recovery, in practice, may not provide the Affected Utilities a reasonable opportunity

26  
27 <sup>1</sup> TEP hereby incorporates by reference the arguments set forth in its Exceptions to the extent that such Exceptions were  
28 not addressed in the Decision or otherwise discussed herein.

29 <sup>2</sup> See, *Application of Trico Electric Cooperative, Inc.*, 92 Ariz. 373, 380, 377 P.2d 309 (1962). See also: *James P. Paul*  
30 *Water Co. v. Ariz. Corp. Com'n*, 137 Ariz. 426, 429-430, 671 P.2d 404 (1983); *Ariz. Corp. Com'n v. Superior Court*,  
105 Ariz. 56, 59, 459 P.2d 489 (1969), *Tonto Creek Estates v. Ariz. Corp. Com'n*, 177 Ariz. 49, 58, 864 P.2d 1081 (Ct.  
App. 1993).

1 to collect 100 percent of their stranded costs.

2 The Auction and Divestiture Approach.

3 TEP's primary concerns regarding the Divestiture/Auction Methodology language set forth in  
4 the Decision include, but are not limited to: (a) it does not establish an interim CTC prior to  
5 divestiture; (b) it does not provide an assurance of an opportunity for 100 percent recovery if an  
6 Affected Utility elects to divest, but the divestiture plan is not approved by the Commission or, if  
7 after going through the process, the Affected Utility is unable to sell some or all of the generation  
8 assets; (c) there is no specific reference to the Affected Utilities ability to recover 100 percent of  
9 regulatory assets; (d) the impact of the rate freeze set forth in the Decision during the recovery  
10 period; (e) the inconsistency in the second and third paragraphs of the method regarding negative  
11 stranded cost; and (f) the inconsistency of the October 1, 1998 filing date and the sixty day filing  
12 requirement on page 12, line 21 of the Order. The Company believes that all of these issues are  
13 easily rectified and is committed to resolving these issues in a collaborative manner.

14 The Company is also concerned that the Commission lacks the authority to require, either  
15 directly or otherwise, the Affected Utilities to divest their generation assets as a condition to  
16 recovering stranded costs.<sup>3</sup> Page 10, lines 22 – 27 of the Decision states:

17 As previously noted, we find the Affected Utilities should have a  
18 reasonable opportunity to collect 100 percent of their stranded costs.  
19 Although we cannot go as far as to agree with those parties who  
20 advocate that no stranded cost recovery should be allowed for Affected  
21 Utilities that do not divest, we do believe that the opportunity for full  
22 stranded cost recovery should be allowed only for Affected Utilities  
23 that choose to divest. For Affected Utilities who do not divest, it is  
appropriate for the Commission to devise a different approach to deal  
with a particular set of circumstances.

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24 <sup>3</sup> In *Missouri ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n*, 262 U.S. 276, 289, 43 S. Ct. 544, 547 (1923),  
25 the United States Supreme Court held that regulatory agencies, such as the Commission, can not force public service  
26 corporations to take actions regarding the ownership of their property that are reserved to the discretion of management.  
27 See, *Southern Pacific Co. v. Ariz. Corp. Comm'n*, 98 Ariz. 339, 343, 404 P.2d 692 (1965); ("It is not the purpose of the  
28 regulatory bodies to manage the affairs of the corporation."); *Re Elec. Ind. Restructuring* 163 P.U.R. 4<sup>th</sup> 96 at n. 31;  
29 *Carmel Mtn. Ranch v. San Diego Gas & Elec. Co.*, 1988 Cal. P.U.C. LEXIS 67 at 14-15 (Mar. 9, 1988). Courts have  
also ruled against forced divestiture as being an unconstitutional taking of public service corporation property. *Public*  
30 *Util. Comm's v. Home Light & Power Co.*, 428 P.2d 928, 935 (Colo. 1967). In Arizona, the Supreme Court has held that  
the Commission cannot exercise any implied powers, but only those that are expressly granted by the Constitution or  
implementing statutes. *Commercial Life Ins. Co. v. Wright*, 64 Ariz. 129, 139, 166 P.2d 943, 949 (1946).

1 TEP believes that this language should be modified to provide that to the extent the Commission  
2 devises a different approach to deal with a particular set of circumstances, the opportunity for 100  
3 percent recovery should still be available.

4 The Commission's Transition Revenues Methodology is Vague and has Serious Financial  
5 Implications.

6 The Decision provides an alternative to auction and divestiture called the "transition revenues  
7 methodology". The description of this option on page 12 of the Decision states:

8  
9 The second option would be to provide sufficient revenues necessary  
10 to maintain financial integrity, such as avoiding default under currently  
11 existing financial instruments for a period of ten years, at the end of  
12 which time there would be no remaining stranded costs, or for the  
13 Commission to otherwise provide an allocation of stranded cost  
responsibilities and risks between ratepayers and shareholders as is  
determined to be in the public interest for a given Affected Utility.

14 Again, in theory the idea of permitting an Affected Utility to maintain its financial integrity  
15 may sound appealing, but in practice, it falls short of the principle that the Commission should  
16 provide for an opportunity to recover 100 percent of stranded costs. There is no basis for the  
17 Commission to abandon its primary objective of providing an opportunity for 100 percent recovery  
18 of stranded costs, yet this option on its face does not provide an opportunity for 100 percent  
19 recovery.

20 The Commission's description of the transition revenues option is too vague. It fails to  
21 identify critical elements including, but not limited to: (a) how financial integrity would be  
22 measured; (b) how revenues would be determined and collected by the Affected Utility; (c) what  
23 would happen in cases where financial instruments are in place for longer than the 10 year  
24 "transition" period; (d) how the Commission would determine whether to allocate risks between  
25 shareholders and customers; (e) the FAS 71 implications; (f) no specific reference to the Affected  
26 Utilities' ability to recover 100 percent of regulatory assets; (g) how does the rate freeze set forth in  
27 the Decision impact this method; and (h) how the Commission would treat Affected Utilities whose  
28 financial position drastically changed (for better or for worse) during the transition period. Again,  
29 the Company believes that all of these issues are easily rectified and is committed to resolving these  
30 issues in a collaborative manner.

1 For all of these reasons, TEP requests that the Commission reconsider and clarify the options  
2 that it has authorized for stranded cost recovery and conform them to the basic legal principles of due  
3 process and fundamental fairness.

4 **FAILURE TO PROVIDE A REASONABLE OPPORTUNITY TO RECOVER 100**  
5 **PERCENT OF STRANDED COSTS WOULD CONSTITUTE AN UNCONSTITUTIONAL**  
6 **TAKING OF TEP'S PROPERTY WITHOUT JUST COMPENSATION**

7 If the Commission fails to provide a viable means by which Affected Utilities can recover all  
8 of their stranded costs, then it will have confiscated property without just compensation. The  
9 underlying assets and investments that constitute the stranded costs of the Affected Utilities are  
10 private property that cannot be taken by the government without due process of law and the payment  
11 of just compensation. (U.S. Const. amend. V, XV; Ariz. Const. Art. II, §§ 4, 17). The Affected  
12 Utilities have invested their property in good faith reliance upon the representations of the  
13 government that they would recover those investments and have a reasonable opportunity to earn a  
14 fair rate of return thereon through the rates that were approved by the Commission. By failing to  
15 provide a mechanism for complete recovery of those costs as part of the transition to a competitive  
16 ratemaking scheme, the Commission (and therefore the State) is taking from the Affected Utilities  
17 the value of those non-recoverable and un-recoverable property.

18 **OTHER ISSUES**

19  
20 **Rate Freeze**

21 The discussion on page 18, lines 3 – 18 indicates that “no customer will receive a rate  
22 increase as a result of stranded costs.” TEP believes that such a provision is contradictory to a  
23 competitive environment and may conflict with an Affected Utilities’ ability to recover stranded  
24 costs. However, to the extent the Commission determines the need for a rate cap to be implemented,  
25 the Affected Utilities should not be unfairly penalized in terms of their ability to recover stranded  
26 costs via the CTC for circumstances outside of their control. If the CTC is required to be lowered  
27 due to the cap, the recovery period should be extended to provide the Affected Utility the  
28 opportunity to collect all of its stranded costs.

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1 Special Contracts

2 TEP believes that special contract customers should be responsible for stranded costs just as  
3 all other customers. As proposed, all customers would pay stranded costs based on their current  
4 allocations of costs for ratemaking purposes. To the extent that such allocated costs are in contracted  
5 rates, current contract price levels should not be exceeded when prices, including stranded costs, are  
6 unbundled for competition. Customers whose contracts have lower pricing levels than their previous  
7 allocations for ratemaking purposes, must either be responsible for costs up to their allocated level or  
8 such cost differences should be reallocated. Otherwise, Affected Utilities will be required to write-  
9 off any shortfalls. Further, special contract customers must be responsible for stranded cost recovery  
10 through the full period of recovery. Otherwise, the allocations to other customer classes, or Affected  
11 Utility write-offs, will be excessively large. There also may be a "fairness" problem if such  
12 customers are "off the hook" far in advance of other customers solely due to the fact that they had  
13 contracts.

14 Self-Generation Exclusion

15 TEP also disagrees with the assertion in the Decision that Rule R14-2-1607.J should not be  
16 modified. If the Rule is not modified to ensure that customers who choose to self-generate are  
17 responsible for stranded costs just as any other existing customer, a potentially large and improper  
18 economic incentive for self-generation will be created. This is due to the ability of such customers to  
19 avoid stranded cost charges. The result of the Rule as written will be to significantly increase self-  
20 generation while increasing stranded cost burdens on customers who purchase their power in the  
21 competitive marketplace. This is of particular importance to ensure that special contract customers  
22 pay their fair share as discussed above.

23 Infrastructure Costs

24 Page 13, lines 20-22 of the Decision states, "While the Affected Utilities may have additional  
25 costs related to transactions in implementing electric competition, those costs, if reasonable, can be  
26 factored into the market price." TEP takes exception to this statement. The cost of infrastructure  
27 required to implement competition should be borne by the customer via a distribution transition  
28 charge levied on all customers. Affected Utilities should not be put at a competitive disadvantage by  
29 bearing the costs of the required infrastructure to implement competition. As is evident by other

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1 states' experiences, such costs are not trivial and must be shared equitably by all participants in the  
2 new marketplace.

3 Prudency

4 Page 15, line 19 of the Decision states, "It is not the Commission's intent to go back and  
5 revise previous prudency determinations." Yet the next sentence contradicts the previous sentence  
6 by stating that, "This does not mean that the Commission may not consider changed circumstances  
7 and resulting management decisions subsequent to previous prudency determinations." Rule R14-2-  
8 1607.I should be amended to provide specific language that prior prudency decisions will not be  
9 revisited.

10 Missing Word

11 Page 15, line 11 of the Decision should have the word "not" after the word "do".

12 CONCLUSION

13 TEP requests that the Commission reconsider the Decision to modify and otherwise resolve  
14 the issues set forth in this Motion for Reconsideration.

15 RESPECTFULLY SUBMITTED this 9th day of July, 1998.

16 TUCSON ELECTRIC POWER COMPANY

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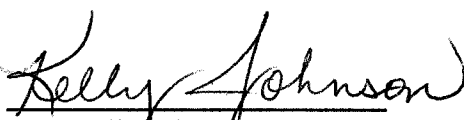
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